

**Department of Health**

**For the Year Ended  
June 30, 2002**

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STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**

State Capitol  
Nashville, Tennessee 37243-0260  
(615) 741-2501

John G. Morgan  
Comptroller

April 3, 2003

The Honorable Phil Bredesen, Governor  
and

Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

and  
The Honorable Kenneth S. Robinson, M.D., Commissioner  
Department of Health  
Cordell Hull Building, 426 Fifth Avenue North  
Nashville, Tennessee 37247

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Health for the year ended June 30, 2002.

The review of management's controls and compliance with policies, procedures, laws, and regulations resulted in certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan  
Comptroller of the Treasury

JGM/th  
02/097



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COMPTROLLER OF THE TREASURY  
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December 11, 2002

The Honorable John G. Morgan  
Comptroller of the Treasury  
State Capitol  
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Health for the year ended June 30, 2002.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Department of Health's compliance with the provisions of policies, procedures, laws, and regulations significant to the audit. Management of the Department of Health is responsible for establishing and maintaining internal control and for complying with applicable laws and regulations.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's administration has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the department's internal control and instances of noncompliance to the Department of Health's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA,  
Director

AAH/th

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit

**Department of Health**

For the Year Ended June 30, 2002

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## AUDIT SCOPE

We have audited the Department of Health for the period July 1, 2001, through June 30, 2002. Our audit scope included those areas material to the *Tennessee Comprehensive Annual Financial Report* for the year ended June 30, 2002, and the *Tennessee Single Audit Report* for the same period. These areas included the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) and the Block Grant for Prevention and Treatment of Substance Abuse (SAPT). In addition to those areas, our primary focus was on management's controls and compliance with policies, procedures, laws, and regulations in the areas of contracts, equipment, deferred revenue, the Patient Tracking and Billing Management Information System, the Alcohol and Drug Management Information System, utilization of the Department of Finance and Administration's State of Tennessee Accounting and Reporting System (STARS) grants module to record the receipt and expenditure of federal funds, and travel claims. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

## AUDIT FINDINGS

### **CFDA Numbers and Program Names Not Provided to Subrecipients**

The department did not inform subrecipients of all Catalog of Federal Domestic Assistance Numbers and federal program names (page 11).

### **Department Circumvented State's Employment Process to Obtain Staffing Services\*\***

The department has used grant agreements with a nonprofit organization, community services agencies, and human resource agencies to obtain staffing services (page 13).

**Inadequate Contract Controls\*\***

The department did not approve contracts before the beginning of the contract period (page 15).

**Equipment Losses Not Reported Timely to Comptroller**

The department did not maintain proper accountability over its equipment and failed to notify the Office of the Comptroller of the Treasury of lost or stolen equipment timely (page 17).

\*\* This finding is repeated from prior audits.

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"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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**Audit Report  
Department of Health  
For the Year Ended June 30, 2002**

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# **Department of Health For the Year Ended June 30, 2002**

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## **INTRODUCTION**

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### **POST-AUDIT AUTHORITY**

This is the report on the financial and compliance audit of the Department of Health. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

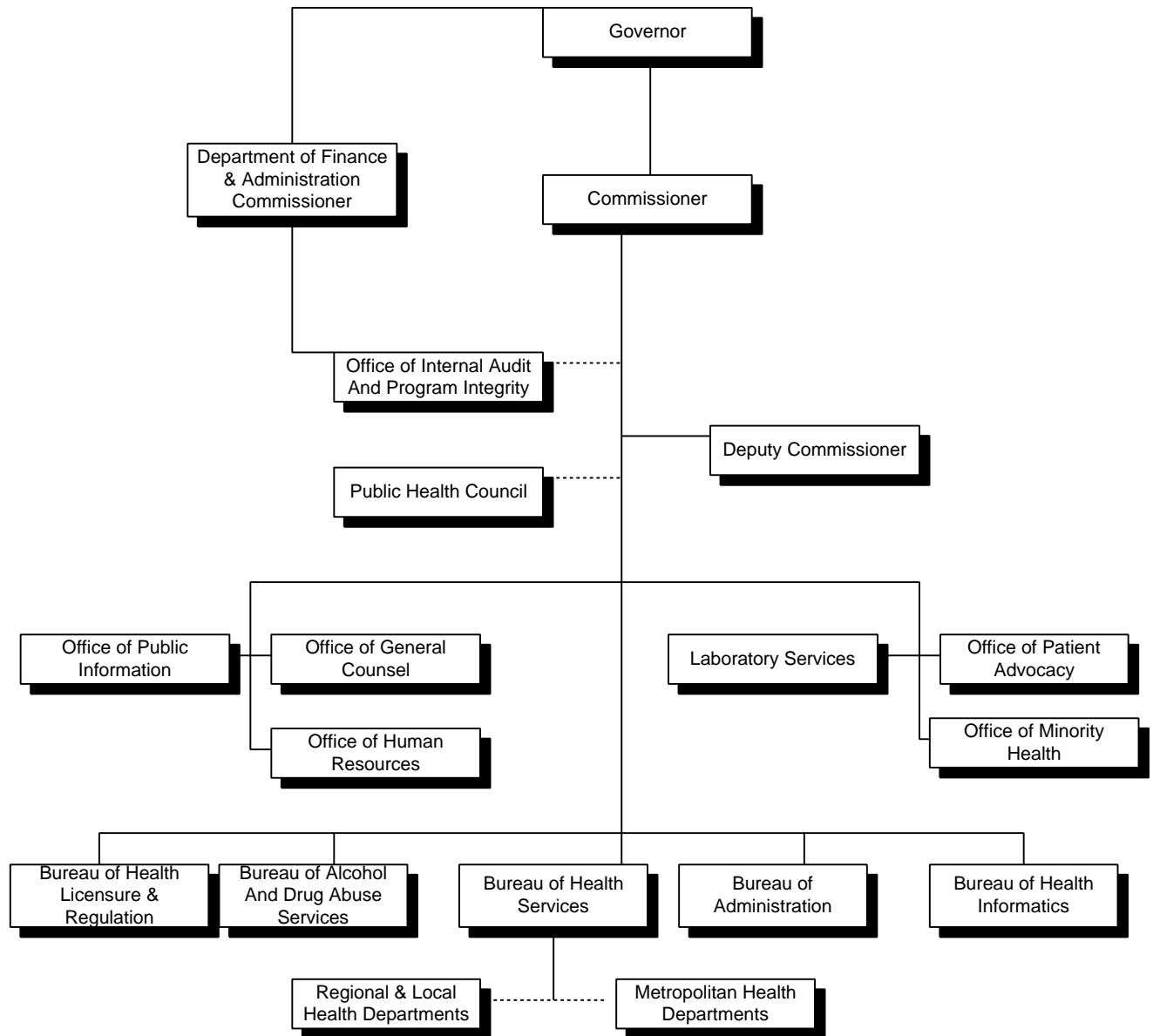
### **BACKGROUND**

The mission of the Department of Health is to promote, protect, and restore the health of Tennesseans by facilitating access to high-quality preventive and primary care services. To fulfill this mission, the department comprises six functional sections: Executive Administration, Bureau of Administration, Bureau of Health Licensure and Regulations, Bureau of Alcohol and Drug Abuse Services, Bureau of Health Services, and Bureau of Health Informatics.

One of the department’s many responsibilities is to provide overall direction to, coordination of, and supervision for the state and local health departments to enable them to meet the health needs of the state’s citizens. The department ensures the quality of medical resources available in the state through the regulation, certification, and licensure of health professionals and health care facilities. The central office works in coordination with eight rural and six metropolitan regional offices and 95 county health departments to provide services which protect and promote health and prevent disease and injury. The department also works to improve access to quality health care services in underserved areas of the state and to underserved populations. To decrease the incidence and prevalence of alcohol and other drug abuse and dependence, the department coordinates prevention, treatment, and rehabilitation services. The department is also responsible for preserving and issuing copies of all vital records.

An organization chart of the department is on the following page.

## Department of Health Organization Chart



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## AUDIT SCOPE

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We have audited the Department of Health for the period July 1, 2001, through June 30, 2002. Our audit scope included those areas material to the *Tennessee Comprehensive Annual Financial Report* for the year ended June 30, 2002, and to the *Tennessee Single Audit Report* for the same period. These areas include the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) and the Block Grant for Prevention and Treatment of Substance Abuse (SAPT). In addition to those areas, our primary focus was on management's controls and compliance with policies, procedures, laws, and regulations in the areas of contracts, equipment, deferred revenue, the Patient Tracking and Billing Management Information System, the Alcohol and Drug Management Information System, utilization of the Department of Finance and Administration's State of Tennessee Accounting and Reporting System (STARS) grants module to record the receipt and expenditure of federal funds, and travel claims. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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## PRIOR AUDIT FINDINGS

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Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Health filed its report with the Department of Audit on October 30, 2002. A follow-up of all prior audit findings was conducted as part of the current audit.

## RESOLVED AUDIT FINDINGS

The current audit disclosed that the Department of Health has corrected the previous audit findings concerning the

- detection of dual participation between the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) and the Commodity Supplemental Food Program (CSFP); and
- monitoring of subrecipient expenditure reports.

## REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning

- the department's use of grant agreements to circumvent the state's employment process to obtain staffing services, and
- untimely approval of contracts.

These findings have not been resolved and are repeated in the Objectives, Methodologies, and Conclusions section of this report.

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## OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

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### AREAS RELATED TO TENNESSEE'S COMPREHENSIVE ANNUAL FINANCIAL REPORT AND SINGLE AUDIT REPORT

Our audit of the Department of Health is an integral part of our annual audit of the *Comprehensive Annual Financial Report* (CAFR). The objective of the audit of the CAFR is to render an opinion on the State of Tennessee's basic financial statements. As part of our audit of the CAFR, we are required to gain an understanding of the state's internal control and determine whether the state complied with laws and regulations that have a material effect on the state's basic financial statements.

Our audit of the Department of Health is also an integral part of the *Tennessee Single Audit*, which is conducted in accordance with the Single Audit Act, as amended by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The Single Audit Act, as amended, requires us to determine whether

- the state complied with rules and regulations that may have a material effect on each major federal financial assistance program, and
- the state has internal control to provide reasonable assurance that it is managing its major federal programs in compliance with applicable laws and regulations.

We determined the following areas within the Department of Health were material to the CAFR and/or to the *Single Audit Report*: the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) and the Block Grant for Prevention and Treatment of Substance Abuse (SAPT).

To address the objectives of the audit of the CAFR and the *Single Audit Report*, as they pertain to these two major federal award programs, we interviewed key department employees, reviewed applicable policies and procedures, and tested representative samples of transactions. For further discussion, see the WIC and SAPT section.

We have audited the basic financial statements of the State of Tennessee for the year ended June 30, 2002, and have issued our report thereon dated January 17, 2003. The opinion on the financial statements is unqualified. The *Tennessee Single Audit Report* for the year ended June 30, 2002, includes our reports on the schedule of expenditures of federal awards and on internal control and compliance with laws and regulations. These reports include a reportable condition resulting from this audit.

The audit of the department revealed the following finding in areas related to the CAFR and the *Single Audit Report*:

- The department did not inform subrecipients of all Catalog of Federal Domestic Assistance numbers and program names. See finding 1.

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**SPECIAL SUPPLEMENTAL NUTRITION PROGRAM FOR WOMEN, INFANTS, AND CHILDREN (WIC) AND BLOCK GRANT FOR PREVENTION AND TREATMENT OF SUBSTANCE ABUSE (SAPT)**

The two major federal programs for the Department of Health were audited for the applicable compliance requirements as noted in the U.S. Office of Management and Budget Circular A-133, *Compliance Supplement for Audits of States, Local Governments, and Non-Profit Organizations*. These two major programs are the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) and the Block Grant for Prevention and Treatment of Substance Abuse (SAPT).

To address the objectives of the CAFR and the Single Audit, as they pertain to federal financial assistance programs, our audit focused primarily on the compliance requirements for WIC and SAPT.

This portion of the audit covered the following areas:

- Activities Allowed or Unallowed and Allowable Costs / Cost Principles
- Cash Management
- Eligibility
- Matching, Level of Effort, Earmarking
- Period of Availability of Federal Funds
- Procurement and Suspension and Debarment
- Reporting
- Subrecipient Monitoring
- Special Tests and Provisions
- Schedule of Expenditures of Federal Awards

## **Activities Allowed or Unallowed and Allowable Costs / Cost Principles**

The primary objectives for WIC and SAPT were to determine if

- funds were used for allowable purposes, and
- expenditures involving federal funds have been recorded correctly as to the proper grant program and applicable federal grant.

An additional objective for WIC was to determine if costs meet the criteria set forth in the “Basic Guidelines” of OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, Attachment A, paragraph C.

Supporting documentation for all WIC and SAPT significant items and a nonstatistical sample of SAPT expenditures were reviewed and tested to determine if funds were used for allowable purposes and appropriately recorded to the proper grant program and applicable federal grant. Also, where applicable, the items were tested for compliance with travel regulations, contract terms, and purchasing guidelines. Supporting documentation for all WIC significant items was reviewed and tested to determine if costs were in compliance with OMB Circular A-87.

Our testwork indicated that the department’s federal WIC and SAPT funds appeared to be used for allowable activities, and expenditures appeared to be recorded correctly as to the proper grant program and the applicable federal grant. Costs for WIC appeared to be in compliance with OMB Circular A-87.

## **Cash Management**

The primary objectives for WIC and SAPT were to determine if

- the department complied with the Cash Management Improvement Act Agreement between the State of Tennessee and the Secretary of the Treasury, United States Department of the Treasury, and other federal cash management regulations; and
- the department’s reporting of receipt and disbursement transactions to the Department of Finance and Administration was adequate.

For WIC and SAPT, the department’s policies and procedures for recording and reporting the costs and drawdowns to the Department of Finance and Administration were reviewed and discussed with the appropriate personnel to determine whether reporting of transactions was adequate. We selected a nonstatistical sample of drawdown transactions and compared the process dates of the expenditure transactions in the State of Tennessee Accounting and Reporting System (STARS) with the dates the funds were requested from the federal agency to determine if drawdown requests were in compliance with the Cash Management Improvement Act. We also examined deferred revenue transactions at fiscal year end to determine if the department complied with other federal cash management regulations.

Our testwork indicated that the department complied with the Cash Management Improvement Act Agreement between the State of Tennessee and the Secretary of the Treasury, United States Department of the Treasury, and other federal cash management regulations, and the department's reporting of receipt and disbursement transactions to the Department of Finance and Administration was adequate.

## **Eligibility**

The objectives for WIC were to determine if individual program participants were deemed eligible (including obtaining any required documentation/verifications), and the department only gave WIC grant awards to eligible organizations.

A nonstatistical sample of WIC participants was selected. We accessed the Patient Tracking and Billing Management Information System and reviewed each selected participant's records for the appropriate information to determine if the department made an appropriate determination as to whether the participant was income-eligible, met the residency requirement, was given the correct status or category, and was certified for nutritional risk by a qualified nutritionist. We reviewed WIC grant awards to determine if the grant recipient organizations were eligible to receive the WIC grant.

Our testwork indicated that the department or subrecipient made the correct eligibility determinations for individuals, and WIC grant awards were only given to eligible organizations.

## **Matching, Level of Effort, Earmarking**

The primary objective for SAPT was to determine if the department met the required level of effort and earmarking requirements. Matching is not a requirement for the SAPT block grant.

OMB Circular A-133, *Compliance Supplement for Audits of States, Local Governments, and Non-Profit Organizations*, and other program guidelines were reviewed for program objectives, procedures, and major compliance requirements. The amount of non-federal funds expended for the year ending June 30, 2002, and the average level of expenditures maintained for the preceding two-year period were obtained and reviewed to determine if the department maintained state expenditures for authorized activities in accordance with the level of effort requirements.

The state must maintain grant expenditures for Substance Abuse treatment services for pregnant women and women with dependent children in accordance with the level of effort requirements. Also, the state must maintain expenditures of non-federal amounts for HIV and tuberculosis services in accordance with the level of effort requirements. The expenditures were traced to supporting documentation.

Required percentages or amounts of the block grant funds are to be expended for prevention and treatment activities regarding alcohol, for prevention and treatment of other drugs, for one or more projects to make available to individuals early intervention services for HIV disease at the sites where the individuals are undergoing Substance Abuse treatment, and

for the costs of administering the grant. The amounts of block grant funds were traced to the State of Tennessee Accounting and Reporting System (STARS) to determine if the required percentages were met.

Based on our testwork, the department met the required level of effort and earmarking requirements.

### **Period of Availability of Federal Funds**

The primary objective for WIC and SAPT was to determine if the department obligated federal funds within the period of availability and obligations were liquidated within the required time period.

Financial reports, contracts, and expenditures were reviewed and traced to supporting documentation to determine if funds were obligated and expended within periods allowed.

Based on our review of financial reports, contracts, and expenditures, the department obligated federal funds within the period of availability, and obligations were liquidated within the required time period.

### **Procurement and Suspension and Debarment**

The primary objective for WIC and SAPT was to determine if all subawards, contracts, and agreements for purchase of goods or services contained a clause stating that the contractor had not been suspended or debarred.

All WIC and a nonstatistical sample of SAPT contracts were obtained and reviewed for the clause stating that the contractor had not been suspended or debarred and for the appropriate signature.

Based on our testwork, it appeared no subaward, contract, or agreement for purchase of goods or services was made without the required certification that the contractor had not been suspended or debarred.

### **Reporting**

The primary objective for WIC and SAPT was to determine if the required reports for federal awards included all activity of the reporting period, were supported by applicable accounting or performance records, and were presented in accordance with program requirements. An additional objective for WIC was to follow up on the prior audit finding concerning detection of dual participation between WIC and the Commodity Supplemental Food Program (CSFP).

The required financial reports for WIC federal awards were reviewed for completeness. Key line items on the *WIC Monthly Financial Management and Participation Report* and *WIC Program Annual Closeout Report* were traced to documentation to determine if the reports were adequately supported and presented in accordance with program requirements. The required



monthly WIC and CSFP dual participation reports were requested to determine if the department was producing and reviewing the reports.

For SAPT, the key line items on the *Summary of Tobacco Results by State Geographic Sampling Unit* were traced to adequate supporting documentation provided by the Tennessee Department of Agriculture to determine if the department was performing the required inspections of establishments that sell tobacco products in accordance with program requirements. We also reviewed the report to determine that it was presented in accordance with program requirements.

Based on our reviews and testwork, it appears that the required reports for federal awards included all activity of the reporting period, were supported by applicable accounting or performance records, and were presented in accordance with program requirements. Also, the department is producing and reviewing the dual participation reports for the WIC and CSFP programs.

### **Subrecipient Monitoring**

The primary objectives for both WIC and SAPT were to determine whether

- the department has identified the federal award information and applicable compliance requirements to subrecipients;
- the department's procedures for monitoring local agencies' eligibility and activity, for monitoring program subrecipients at both program and fiscal levels, and for evaluating authorized vendors were adequate;
- the department was in compliance with the Department of Finance and Administration's Policy 22 concerning subrecipient monitoring;
- the Program Accountability and Review (PAR) monitoring covered the required areas;
- the department received and processed PAR monitoring reports; and
- the department's procedures for obtaining and reviewing subrecipients' audit reports to identify and resolve subrecipient weaknesses in internal control, instances of noncompliance with subrecipient agreements, and questioned costs were functioning in accordance with prescribed requirements.

Two nonstatistical samples of grant contracts were tested to determine if the department had identified federal award information and applicable compliance requirements to the subrecipients. The department's procedures for monitoring local agencies' eligibility and activity, for monitoring program subrecipients at both program and fiscal levels, and for evaluating authorized vendors were reviewed and evaluated for adequacy. The department's procedures for evaluating subrecipients to be monitored, developing a monitoring plan, and submitting the monitoring plan and annual report were reviewed and evaluated to determine compliance with the Department of Finance and Administration's Policy 22. The population of WIC and SAPT subrecipients monitored by PAR was tested to determine if the monitoring

covered the required areas. A nonstatistical sample of PAR monitoring reports was reviewed to determine if the department received and processed the monitoring reports. The department's procedures were reviewed to determine if the department obtained and evaluated subrecipients' audit reports timely. We also tested a nonstatistical sample of audit reports to determine if monitoring results were documented and whether deficiencies were corrected appropriately and timely.

Based on our review and testwork, the department did not inform subrecipients of all federal award information and applicable compliance requirements (see finding 1). Our testwork determined that the department's procedures for monitoring local agencies' eligibility and activity, for monitoring program subrecipients at both program and fiscal levels, and for evaluating authorized vendors were adequate. The department also complied with the Department of Finance and Administration's Policy 22 and received and processed PAR monitoring reports adequately. In addition, the department ensured that the PAR monitoring covered the required areas. Furthermore, the department's procedures for obtaining and reviewing subrecipients' audit reports for the purpose of identifying and resolving subrecipient weaknesses in internal control, instances of noncompliance with subrecipient agreements, and questioned costs were adequate.

## **Special Tests and Provisions**

### **One-to-One Reconciliation**

For WIC, the primary objective was to determine whether the department's food instruments reconciliation process complied with the one-to-one reconciliation requirement.

Reconciliation reports of redeemed food instruments and exception listings were reviewed to determine that the department's nonreconciliation rate did not exceed one percent. We reviewed the department's controls over the bank's contract with WIC to determine if food instruments were redeemed in compliance with the one-to-one reconciliation requirements.

Based on our reviews and testwork, the department's reconciliation process of food instruments complied with the one-to-one reconciliation requirement.

### **Management Evaluations**

For WIC, the primary objectives were to determine whether the department ensured that the local agency management reviews were conducted and covered the required areas.

The Summary of Clinic Reviews and Clinic Listings was obtained, and all reviewed regions were tested to determine if the required local agency management review was conducted, including on-site visits to a minimum of 20% of the clinics in the region. Also, the sample was tested to determine if the local agency management reviews covered the required areas.

Our review and testwork indicated that the reviews were conducted and covered the required areas, and that the department complied with the 20% monitoring requirement.

### Independent Peer Reviews

For SAPT, the primary objectives were to determine whether the required number of entities were peer reviewed, the selection of entities for peer review was representative of entities providing services, and the state ensured that the peer reviewers were independent and covered the required areas.

We obtained and reviewed the listing of agencies providing treatment programs and the listing of agencies receiving peer reviews to determine if the number of entities reviewed was in compliance with the federal requirements, including if the selected entities were representative of entities providing service. Also, we reviewed the state's procedures for ensuring that the peer reviewers were independent and tested the population of reviewed treatment programs to ensure that those procedures were followed and covered the required areas.

Based on our reviews and testwork, the required number of entities were peer reviewed, the selection of entities was representative of entities providing services, and the state ensured that the peer reviewers were independent and covered the required areas.

### **Schedule of Expenditures of Federal Awards**

Our objective was to verify that the Schedule of Expenditures of Federal Awards was properly prepared and adequately supported. We verified the grant identification information on the Schedule of Expenditures of Federal Awards, and total disbursement amounts were traced to supporting documentation. Based on the testwork performed, we determined that the Schedule of Expenditures of Federal Awards appeared to be properly prepared and adequately supported.

### **Finding, Recommendation, and Management's Comment**

#### **1. The department did not inform subrecipients of all CFDA numbers and program names**

##### **Finding**

The Department of Health has not informed subrecipients of all *Catalog of Federal Domestic Assistance* (CFDA) Numbers and federal program names. The department has entered into contracts with a nonprofit organization, community services agencies (CSAs), and human resource agencies (HRAs) to assist in implementing different state and federal grant programs. When these entities invoice the department, the department pays and accounts for expenditures in a clearing account, which is reallocated to all of the different programs provided at the appropriate county health department. Once the reallocation is performed, appropriate federal funds are drawn to cover these expenditures. The department reallocates and draws down grant money from multiple federal programs. However, the department has informed these subrecipients of only one CFDA Number and program name, which is mentioned in the grant contracts. Therefore, the local agencies are not aware of the sources of their funding.

Office of Management and Budget Circular A-133, Section 400 (d)(1), states that the pass-through entity is responsible for identifying all “federal awards made by informing each subrecipient of CFDA title and number.”

Failure to inform subrecipients about all CFDA numbers and program names could result in subrecipient noncompliance with the applicable federal regulations.

### **Recommendation**

Management should take steps to ensure that subrecipients are informed of all CFDA numbers and program names that are used to fund the subrecipients programs.

### **Management’s Comment**

Management concurs and will ensure that all recipients are furnished with all applicable CFDA numbers and program names.

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## **CONTRACTS**

Our primary objective in the area of contracts was to follow up on the prior audit findings by determining

- whether the department continued to enter into grant agreements to obtain staffing services,
- whether the department allowed contract services to be rendered before proper approvals of the contracts were obtained, and
- whether the department had adequately monitored subrecipients’ quarterly expenditure reports.

We interviewed key department personnel and reviewed terms of contracts, authorizations and dates, contract payment support, memorandums, and expenditure reports.

Based on our testwork, the department did adequately monitor quarterly expenditure reports. However, the department entered into grant agreements to obtain staffing services (see finding 2) and allowed contract services to be rendered before proper approvals of the contracts were obtained (see finding 3).

## Findings, Recommendations, and Management's Comments

### **2. For the past 17 years, the department has continued to circumvent the state's employment process by using grant agreements to obtain staffing services**

#### **Finding**

As noted in audit reports since 1986, the Department of Health has used grant agreements with a nonprofit organization, community services agencies (CSAs), and human resource agencies (HRAs) to obtain staffing services used to assist in implementing programs. The nonprofit organization provides 39 individuals, the community services agencies provide 31 individuals, and the human resource agencies provide 7 individuals. In addition to these 77 relationships, the grant agreements also included 11 vacant positions as of June 30, 2002. Management did not concur with the prior audit finding; however, management did indicate that these individuals could be transferred onto the state payroll if the positions were made available. The following characteristics of these relationships indicate these individuals are acting as state employees.

1. The contractors' employees are performing the same functions as state and county employees and are interchangeable with them. Seventy of the 77 relationships (90.9%) are filling clerk-related, nutrition-related, and/or program-related positions, as of June 30, 2002.
2. The state still retains the basic responsibility for the administration of the programs through the grant agreements with the above-mentioned agencies.
3. The Department of Health or the Department of Personnel establishes the related job specifications, and state employees interview prospective individuals to fill vacant positions.
4. The department assigns and has established the acceptable procedures for day-to-day tasks and responsibilities of these contractors' employees. The department supervises and reviews the performance of the contractors' employees.
5. The department retains the right of termination for these employees for either misconduct or security reasons.
6. The grant agreements do not mention a specific project. The scope of services section in the grant agreements describes work of a day-to-day nature.
7. The contractors invoice the state based upon their employees' actual time worked as opposed to accomplished results.
8. In addition to working in the Cordell Hull state office building and the department's regional offices and county health departments, the contractors' employees also use the state's equipment and supplies.
9. The department uses the Patient Tracking and Billing Management Information System (PTBMIS) in its county health departments. On this system, there is no difference shown between state and contractors' employees. Furthermore, there is no

difference between state and contractors' employees when indirect costs are allocated within the county health departments.

10. The department pays the accrued leave balances of these contractors' employees when their employment is terminated.
11. A departmental policy even states that for these contractors' employees, "salary increases shall be allowable provided they are consistent with salary increases received by State employees," if funding is available or provided for this purpose.

Chapter 0620-3-3-.08(1) of the *Rules of the Department of Finance and Administration* defines a grant as "a contract used to effect an award of funding or property to a grant recipient or grantee. Deliverables pursuant to a Grant Contract shall be comprised of services to third-party beneficiaries rather than services provided to the State." These rules continue to give three examples of acceptable uses of grants. They are

1. a contract effecting an award to a nonprofit organization or governmental entity, the primary purpose of which is to grant funds to finance operations or program activities;
2. a contract passing through a federal award which specifically identifies by name a grantee or subrecipient; or
3. a contract effecting an award to fund work toward the completion of an activity or program which could not otherwise be more advantageously procured under a fee-for-service type contract. . . .

Also, Chapter 0620-3-3-.07(12) of the *Rules of the Department of Finance and Administration* requires that "State employees shall be hired through the merit system of the Department of Personnel." Section 8-30-201(a), *Tennessee Code Annotated*, establishes "a system of personnel administration based on merit principles and scientific methods. That system shall govern the appointment, promotion, transfer, layoff, removal and discipline of employees, and other incidents of state employment." Section 8-30-201(b), *Tennessee Code Annotated*, gives the Department of Personnel the responsibility of administering and improving this system. By entering into these grant agreements, the department in effect circumvented the state's employment process for obtaining staff. The state's employment process would have included a state application, an independent examination by the Department of Personnel, development of a register by the Department of Personnel, and preference given to veterans. Also since the state's employment process was avoided, the Department of Personnel's Rules designed to protect state employees concerning tenure, suspension, termination, privileges, benefits, and other rights would not be available to these contracted employees. For example, these individuals, except for the community service agency's employees, would not have access to the Office of Attorney General and Reporter providing defense counsel. Therefore, the department should not use grant agreements in these situations.

Furthermore, the state apparently has incurred additional cost by contracting with non-state entities to provide individuals. In addition to paying the salaries and benefits, travel, training, and supplies of these "employees," an additional administrative fee is paid to these organizations. Secondly, the department also pays the CSAs for equipment rental and

maintenance, telephone, postage and shipping, printing and publications, insurance, and occupancy for the administrative functions of the community services agencies. Also, the department does not have a current cost-benefit analysis that proves the benefit of this method of obtaining “employees.”

### **Recommendation**

The Department of Health should not use grant agreements with nonprofit organizations, community services agencies, or human resource agencies to provide individuals who are, in effect, performing state services. Either these contractors’ employees should be placed on the state payroll system through the proper employment procedures, or existing state employees should perform all state responsibilities. Also, the department should perform a current cost-benefit analysis, justifying the benefit to the state and the continuation of employing individuals through grant agreements.

### **Management’s Comment**

During Fiscal Year 2004, management will develop a plan in conjunction with the Departments of Finance and Administration and Personnel that will attempt to address the auditors’ concerns with these grant agreements.

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### **3. The department did not approve contracts before the beginning of the contract period**

#### **Finding**

As noted in the four prior audits, the Department of Health did not approve contracts before the beginning of the contract period. Management concurred with the prior audit finding, and improvement has been made in most departmental divisions. However, certain divisions still had unapproved contracts at the beginning of the contract period.

Testwork revealed that 26 of 68 contracts (38.2%) with a beginning date of July 1, 2002, were approved one to 134 days late (an average of 49 days late). As of December 3, 2002, one additional contract with a beginning date of July 1, 2002, was still not approved. An analysis of these late contracts indicated that 16 of these contracts (59.3%) were from the Division of Population-based Services, and 13 contracts (48.1%) were between the department and metropolitan governments or a university in Tennessee. This late approval of contracts resulted because of an increase in the number of contracts in the Division of Population-based Services and the additional contract review process of the metropolitan governments and universities. While no payments were made against a contract until it was fully approved, potential liabilities to the state occurred because the contracts were without proper authorization.

Chapter 0620-3-3-.06(3) of the *Rules of the Department of Finance and Administration* states that “upon approval by the Commissioner of Finance and Administration, a contract shall be fully approved.” If contracts are not approved before the contract period begins and before services are rendered, the state could be obligated to pay for unauthorized services.

### **Recommendation**

The department’s bureau directors should adhere to the department’s deadlines of submitting contracts for review and Commissioner approval to help ensure the contracts will be completely approved before the beginning of the contract period.

### **Management’s Comment**

Management concurs that not all contracts are fully signed before their start date. Based on the auditors’ fieldwork, it appears that certain types of contracts, i.e., ones with multiple approval levels on the contractor side, and certain program areas account for the majority of the department’s late contracts. The department will continue to work with contractors with multiple approval levels (e.g., county governments, universities, metropolitan governments) to ensure more timely return of contracts to the state for final processing. In addition, the department will work with the identified program areas in the department with late contracts to determine the reason for untimely processing.

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## **EQUIPMENT**

Our objectives for reviewing equipment controls and procedures were to determine whether

- policies and procedures regarding equipment were adequate;
- equipment information was properly recorded in the Property of State of Tennessee listing (POST);
- reported lost or stolen equipment had been removed from POST; and
- lost or stolen equipment was reported timely to the Comptroller of the Treasury.

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department’s policies and procedures regarding equipment. We tested two populations and one nonstatistical sample of equipment from POST to determine whether the equipment information was properly recorded including state tag number, description, location, and serial number. We physically observed the equipment located in Davidson County, while all other equipment sample item information was confirmed by letter. In addition, a nonstatistical sample of equipment items reported to the Comptroller of the Treasury as being lost or stolen was selected to determine whether the equipment items had been removed from POST and reported timely to the Comptroller.



Based on our interviews and review of supporting documentation, we determined that equipment policies and procedures are adequate except for not completing an annual inventory and timely reporting of lost or stolen equipment to the Comptroller of the Treasury (see finding 4). Based on our testwork, equipment information is properly recorded in POST for state tag number, description, location, and serial number, and reported lost or stolen equipment items were removed from POST. However, the reported lost or stolen equipment items were not removed within 30 days of being reported to the Comptroller of the Treasury (see finding 4).

## **Finding, Recommendation, and Management's Comment**

### **4. The department did not report lost and stolen items to the Comptroller of the Treasury timely**

#### **Finding**

The Department of Health did not notify the Office of the Comptroller of the Treasury of lost or stolen equipment timely, as required by state law. During the period July 1, 2001, through August 16, 2002, the Department of Health reported 244 lost or stolen equipment items to the Comptroller of the Treasury. The approximate value of the equipment items is \$570,000.

- The department's property officers stated that of the 244 pieces of equipment, 20 pieces were missing before 1996. With years passing before equipment is identified as missing, it appears that the department is not performing adequate annual inventories.
- Fifteen of 25 equipment items reported as lost or stolen (60%) were not reported to the Comptroller of the Treasury by the Office of Audit and Investigations promptly after notification of the loss. The Office of Audit and Investigations reported lost and stolen equipment to the Comptroller from 35 to 171 days after notification.

Section 8-19-501, *Tennessee Code Annotated*, states:

It is the duty of any official of any agency of the state having knowledge of shortages of moneys of the state, or unauthorized removal of state property, occasioned either by malfeasance or misfeasance in office of any state employee, to report the same immediately to the comptroller of the treasury.

- None of the 25 equipment items were removed from the state's Property of the State of Tennessee system (POST) within 30 days of being reported to the Comptroller of the Treasury as missing or stolen. All of the items were eventually removed from POST on October 2, 2002.

Testwork was also performed on 86 pieces of equipment listed as active in POST. Fifteen of the 86 (17%) could not be located. Thirteen of the 15 equipment items (87%) were

under allotment code 343.54, which has not been in the department's chart of accounts since state fiscal year ending June 30, 1996.

Failure to report losses to the Comptroller of the Treasury could result in the untimely follow-up of lost or stolen equipment.

### **Recommendation**

Primary responsibility for safeguarding equipment rests with each of the department's property officers. These individuals should complete an adequate annual inventory and increase safeguards over equipment. The department's property officers should report any lost or stolen equipment to the Office of Audit and Investigations as soon as the losses are discovered.

The Director of the Office of Audit and Investigations should ensure that losses are reported to the Comptroller of the Treasury immediately.

### **Management's Comment**

Management concurs that lost and stolen reports should be filed timelier by the Internal Audit Office. In the future, the Audit Office will forward lost and stolen information to the Comptroller as soon as they learn of the incident. After Audit's investigation, further information will be forwarded to the Comptroller, as appropriate.

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## **DEFERRED REVENUE**

Our objectives were to determine whether

- deferred revenue accounts were used for the intended purpose;
- transactions were properly supported;
- only applicable items were recorded as deferred revenue and in the proper amounts;
- revenue was recognized as earned within the correct fiscal year;
- the department had complied with applicable federal rules, regulations, and guidelines when federal funds were involved; and
- large variances between current and prior-year ending balances were reasonably explained.

We interviewed key department personnel to gain an understanding of the department's procedures for and controls over deposits into the deferred revenue subaccounts and transfers to earned revenue to determine if deferred revenue subaccounts were used for the intended purpose. We also reviewed supporting documentation and tested nonstatistical samples of deferred revenue transactions to determine if only applicable items were recorded as deferred revenue and

for the proper amount, revenue was recognized as earned within the correct fiscal year, and the department complied with applicable federal rules and regulations. We also compared June 30, 2002, subaccount balances with balances reported at June 30, 2001.

Based on our testwork, the deferred revenue accounts were used for the intended purpose, revenue transactions were properly supported, and only applicable items were recorded as deferred revenue and in the proper amounts, and recognized as earned within the correct fiscal year. Testwork also revealed that the department complied with applicable federal rules and regulations. Large variances between current and prior-year balances were explained, and the explanations were supported.

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### **PATIENT TRACKING AND BILLING MANAGEMENT INFORMATION SYSTEM (PTBMIS)**

Our objectives for PTBMIS were to

- obtain an understanding of PTBMIS critical general and application controls and to determine if the controls were in place,
- document the design of PTBMIS, and
- determine that the department had canceled terminated employees' access to PTBMIS.

We interviewed appropriate personnel and reviewed supporting documentation to gain an understanding of PTBMIS and to determine if general and application controls were in place. We reviewed organization charts for the Bureau of Health Informatics to document the design of PTBMIS. The general control policies and procedures concerning security, system changes, and contingency planning were reviewed and assessed to gain an understanding and assess the risk of the general controls. We also reviewed the application control policies and procedures concerning audit trail, input, processing, and output to gain an understanding and assess the risk of the application control. We tested a nonstatistical sample of employee terminations to determine if access had been removed at the time of termination.

Based on our interviews and testwork; we gained an understanding of PTBMIS general and application controls; we determined that critical general and application controls were in place; we documented the design of PTBMIS; and we determined that terminated employees' access to PTBMIS was canceled.

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### **ALCOHOL AND DRUG MANAGEMENT INFORMATION SYSTEM (ADMIS)**

Our objectives for the Alcohol and Drug Management Information System (ADMIS) were to

- obtain an understanding of ADMIS critical general and application controls and to determine if the controls were in place,

- document the design of ADMIS,
- determine whether access was properly approved, and
- determine that program changes were properly performed.

We interviewed appropriate personnel and reviewed supporting documentation to gain an understanding of ADMIS and to determine if controls were in place. We reviewed organization charts for the Bureau of Alcohol and Drug Abuse Services to document the design of ADMIS. The general control policies and procedures concerning security, system changes, and contingency planning were reviewed and assessed to gain an understanding and assess the risk of the general controls. We also reviewed the application control policies and procedures concerning audit trail, input, processing, and output to gain an understanding and assess the risk of the application control. We tested the population of individuals with access to ADMIS to determine whether access was properly approved. We tested a nonstatistical sample of program changes to determine whether those changes had been properly performed.

Based on our interviews and testwork, we gained an understanding of ADMIS and documented the design of ADMIS. We determined that the critical general and application controls were in place, that access was properly approved, and that the program changes were properly performed.

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**DEPARTMENT OF FINANCE AND ADMINISTRATION POLICY 20, “RECORDING OF FEDERAL GRANT EXPENDITURES AND REVENUES”**

Department of Finance and Administration (F&A) Policy 20 requires that state departments whose financial records are maintained on the State of Tennessee Accounting and Reporting System (STARS) fully utilize the STARS grants module to record the receipt and expenditure of all federal funds.

Our objectives were to determine whether

- appropriate grant information was entered into the STARS grant control table upon notification of the grant award, and related revenue and expenditure transactions were coded with the proper grant codes;
- payroll reallocation is proper;
- the department made drawdowns at least weekly using the applicable STARS reports;
- the department had negotiated an appropriate indirect cost recovery plan, and indirect costs were included in drawdowns; and
- the department used the appropriate STARS reports as bases for preparing the department’s schedule of expenditures of federal awards and reports submitted to the federal government.

We interviewed key personnel to gain an understanding of the department’s procedures

and controls concerning Policy 20 and to determine if the department had negotiated an indirect cost recovery plan. We tested significant items for the two major programs and an additional nonstatistical sample of SAPT major program expenditures to determine if expenditure transactions were coded with the proper grant codes. We reviewed supporting documentation and tested a nonstatistical sample of drawdowns and reports submitted to the federal government to determine if indirect costs were included in the drawdowns, drawdowns were made timely using applicable STARS reports, and revenue transactions were coded to the proper grant codes. All grant award notification dates were reviewed and compared to the awards listed in STARS to determine if the grant award was entered timely. We also reviewed payroll cost reallocations and the schedule of expenditures of federal awards. Each grant's total expenditure amount on the schedule and in federal reports was traced to STARS.

Based on our interviews, reviews, and testwork, the department was in compliance with F&A Policy 20. The department had fully utilized the STARS grants module to record the grant award notifications and the receipt and expenditure of all federal funds, appropriate payroll costs were reallocated, the department made drawdowns timely, the department had negotiated an indirect cost recovery plan, and the proper indirect costs were included in the drawdowns. The department also used the appropriate STARS reports as bases for preparing the schedule of expenditures of federal awards and reports submitted to the federal government.

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## **TRAVEL CLAIMS**

Our objectives for reviewing travel claim controls and procedures were to determine whether

- policies and procedures regarding travel claims were adequate, and
- travel claims were in compliance with the Department of Finance and Administration's (F&A) Policy 08 concerning the State of Tennessee's Comprehensive Travel Regulations.

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's policies and procedures regarding travel claims. We tested two nonstatistical samples of paid travel claims to determine whether the travel claims were in compliance with the state's travel regulations. We also tested both samples to determine whether travel claims were properly approved and appropriate.

Based on our interviews and reviews of supporting documentation, we determined that travel claim policies and procedures are adequate. Based on our testwork, we determined that travel claims were in compliance with F&A's Policy 08, and that travel claims were properly approved and appropriate.

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## OBSERVATIONS AND COMMENTS

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### TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30. The Department of Health filed its compliance report and implementation plan on June 28, 2002.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds. The Human Rights Commission is the coordinating state agency for the monitoring and enforcement of Title VI. A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

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## APPENDIX

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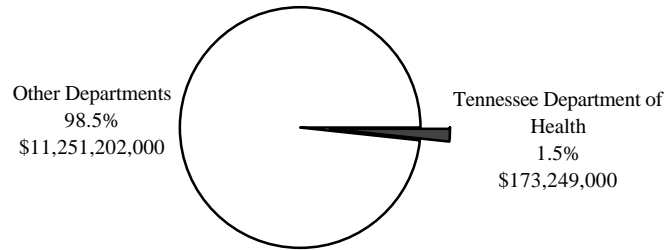
### DIVISIONS AND ALLOTMENT CODES

Department of Health divisions and allotment codes:

343.01	Executive Administration
343.03	Bureau of Administrative Services
343.04	Bureau of Information Systems
343.05	Office of Health Licensure and Regulation
343.07	Emergency Medical Services
343.08	Laboratory Services
343.10	Health Related Boards
343.20	Policy Planning and Assessment
343.39	Division of General Environmental Health
343.44	Bureau of Alcohol and Drug Abuse Services
343.45	Health Services Administration
343.47	Maternal and Child Health
343.49	Communicable and Environmental Disease Services
343.52	Population-Based Services
343.53	WIC Supplemental Foods
343.60	Local Health Services
343.70	Nursing Home Resident's Grant Assistance Program

## General Fund Expenditures

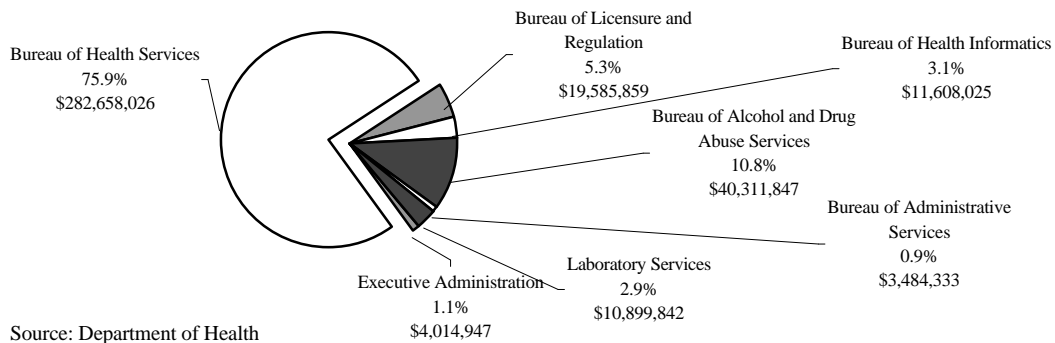
Fiscal Year Ended June 30, 2002 (Unaudited)



Source: Department of Health

## Expenditures by Allotment and Division

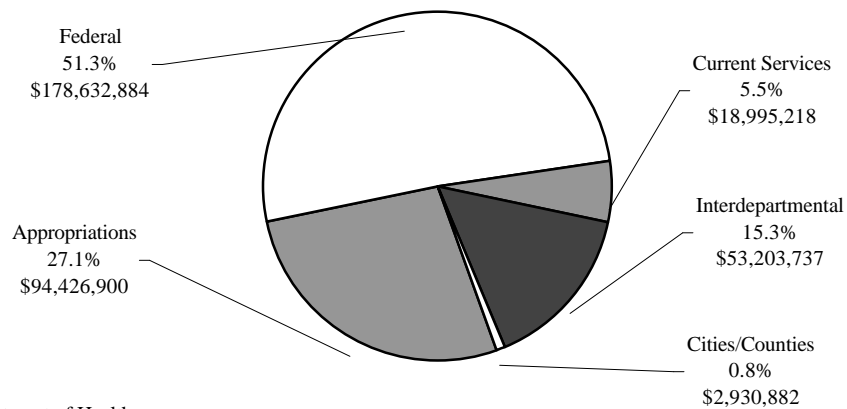
Fiscal Year Ended June 30, 2002 (Unaudited)



Source: Department of Health

## Department of Health Funding Sources

Fiscal Year Ended June 30, 2002 (Unaudited)



Source: Department of Health